Legislative Audit Division

State of Montana

Report to the Legislature

October 1999

Financial Audit

For the Fiscal Year Ended June 30, 1999

Montana Guaranteed Student Loan Program

Commissioner of Higher Education

We performed a financial audit of the Montana Guaranteed Student Loan Program for the fiscal year ended June 30, 1999. This report contains the audited financial statements and accompanying notes for fiscal year 1998-99. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

The current report contains no recommendations to the program. The prior report also contained no recommendations.

Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

99-06

Help eliminate fraud, waste, and abuse in state government. Call the Fraud Hotline at 1-800-222-4446 statewide or 444-4446 in Helena.

FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, will be issued by March 31, 2000. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

October 1999

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 1998-99 financial audit of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program (MGSLP). The objectives of a financial audit include determining if the program's financial statements present fairly its financial position at June 30, 1999, and the results of its operation for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements. Additional compliance testing for the program is included in our biennial audit of the Office of the Commissioner of Higher Education.

The MGSLP was authorized by the Montana Legislature in 1979 and established July 1, 1980. The MGSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by lending institutions and makes administrative cost reimbursements to the MGSLP for acting as a collection agent.

The MGSLP initially contracted with United Student Aid Funds, Inc., to process and service loans. In 1988, the MGSLP began assuming the administrative duties associated with the loan guarantee process. By 1990 the MGSLP assumed complete control, but continues to contract with USA Group Guarantee Services, Inc., for computer support services.

As of June 30, 1999, MGSLP has approximately $624,765,977 of outstanding loans that it has guaranteed. MGSLP personnel have calculated a default rate of 3.33 percent for federal fiscal year 1998-99. Given the current default rate, the federal government will reimburse MGSLP 95 percent of defaulted loans issued after October 1, 1998.

Beginning on page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. The program's response to our audit is on page B-1.

We thank the Commissioner of Higher Education and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Room 135, State Capitol Building, PO Box 201705 Helena MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@state.mt.us

Office of the Commissioner of Higher Education	Dr. Richard A. Crofts	Commissioner of Higher Education
	Joyce Scott	Deputy Commissioner for Academic and Student Affairs
	Rod Sundsted	Associate Commissioner for Fiscal Affairs
	Laurie O. Neils	Director of Budget and Accounting
Montana Guaranteed Student Loan Program	Arlene Hannawalt	Director
	Karen Wing	Fiscal Manager and Financial Analyst

For additional information concerning the Montana Guaranteed Student Loan Program, contact Arlene Hannawalt, Director, at:

PO Box 203101
Helena MT 59620-3101
(406)444-6594

Internet address: ahannawalt@mgslp.state.mt.us

Pearl Allen was the auditor involved in this audit.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the Balance Sheet of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1999, and the related Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual for the fiscal year then ended. These financial statements are the responsibility of the program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Commissioner of Higher Education's Montana Guaranteed Student Loan Program - Special Revenue Fund and are not intended to present fairly the financial position and results of operations of the state of Montana in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1999, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

As discussed in note 1.C to the financial statements, the Commissioner of Higher Education's Montana Guaranteed Student Loan Program separated its funds in accordance with the Higher Education Amendments of 1998. When the program separated these funds, it changed its method of recognizing guarantee fee income and reclassified amounts held for the reserve recall from property held in trust to fund balance, as discussed in notes 8 and 19, respectively, to the financial statements, because the guarantee fees and reserve recall were accounted for in a fund owned by the U.S. Government.

Respectfully submitted,

James Gillett

James H. Gillett, CPA
Deputy Legislative Auditor

September 17, 1999

Room 135, State Capitol Building, PO Box 201705 Helena MT 59620-1705
Phone (406) 444-3122 FAX (406) 444-9784 E-Mail lad@state.mt.us

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Special Revenue Fund
Balance Sheet
As of June 30, 1999

	Agency Operating Fund	Federal Student Loan Reserve Fund
ASSETS		
Cash in Treasury	$1,226,445	$484,754
Short Term Investments (Note 3)	0	5,635,775
Interest Receivable	0	48,098
Accounts Receivable	44,963	5,773
Due From Federal Reserve Fund (Note 13)	638,255	0
Due From Federal Government (Note 2 & Note 10)	34,470	3,082,116
Prepaid Expense	1,319	0
Securities Lending Cash Collateral (Note 4)	0	301,323
Federally Backed Securities (Note 5)	0	2,046,280
Total Assets	$1,945,452	$11,604,119
LIABILITIES AND FUND BALANCE		
LIABILITIES		
Accounts Payable	$331,992	$1,838
Due to Agency Operating Fund (Note 13)	0	638,255
Property Held in Trust (Note 6)	11,890	0
Due to Federal Government (Note 7)	736,702	22,245
Liabilities Under Securities Lending (Note 4)	0	301,323
Total Liabilities	1,080,584	963,661
FUND BALANCE		
Reserved for Recall (Note 18)	0	2,116,092
Reserved for Federal Guarantee Activity (Note 18)	0	8,524,366
Unreserved	864,868	0
Total Fund Balance	864,868	10,640,458
Total Liabilities and Fund Balance	$1,945,452	$11,604,119

The accompanying notes are an integral part of this financial statement.

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Special Revenue Fund
Statement of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual
For the Period July 1, 1998 – June 30, 1999

	Agency Operating Fund			Federal Student Loan Reserve Fund		
	Budget	Actual	Variance	Budget	Actual	Variance
REVENUE						
Guarantee Fee Income (Note 8)	$325,000	$310,772	$(14,228)	$975,000	$517,957	$(457,043)
Administrative Expense Allowance (Note 9)	225,000	155,039	(69,961)	525,000	361,758	(163,242)
Loan Processing and Issuance Fee (Note 10)	0	168,744	168,744	0	0	0
Investment Earnings (Note 3)	75,000	164,132	89,132	225,000	193,019	(31,981)
Collection Costs Retained (Note 11)	650,000	884,450	234,450	0	0	0
Supplemental Pre-claims Assistance (Note 12)	90,000	95,612	5,612	270,000	109,207	(160,793)
Default Aversion Fees (Note 13)	0	638,255	638,255	0	0	0
Account Maintenance Fee (Note 14)	0	571,984	571,984	0	0	0
Accrued Interest (Note 15)	0	24,458	24,458	0	76	76
Non-Reinsured Loan Recoveries (Note 16)	0	123,959	123,959	0	18,331	18,331
Escrow Disbursement Service Fees (Note 6)	96,000	103,850	7,850	0	0	0
Retained FFELP Consolidation Costs (Note 11)	450,000	287,222	(162,778)	0	0	0
Retained FDSLP Consolidation Costs (Note 11)	750,000	1,371,656	621,656	0	0	0
Reinsurance from Dept of Education (Note 20)	4,379,587	4,300,429	(79,158)	15,737,658	14,528,270	(1,209,388)
Net Securities Lending Income Over Exp (Note 4)	0	536	536	0	0	0
Miscellaneous	120,000	11,623	(108,377)	0	0	0
TOTAL REVENUE	7,160,587	9,212,721	2,052,134	17,732,658	15,728,618	(2,004,040)
EXPENDITURES						
Administrative Costs	$5,445,870	$4,226,136	$(1,219,734)	$0	$0	$0
Claims Paid to Lenders (Note 20)	4,379,587	4,300,429	(79,158)	15,737,658	14,528,270	(1,209,388)
Claims Paid to Lenders (non-reinsured) (Note 20)	3,799	35,384	31,585	11,396	163,785	152,389
Default Aversion Fees (Note 13)	0	0	0	0	638,255	638,255
Debt Service	3,749	3,748	(1)	0	0	0
Total Expenditures	9,833,005	8,565,697	(1,267,308)	15,749,054	15,330,310	(418,744)
Excess Revenues Over Expenditures	(2,672,418)	647,024	3,319,442	1,983,604	398,308	(1,585,296)
Prior Year Adjustment (Note 8)	0	(3,044)	(3,044)	0	744,151	744,151
Fund Balance 06/30/98	5,703,305	5,703,305	0	50,828	50,828	0
Reclassification of Prop Held in Trust (Note 19)	0	0	0	1,058,046	1,058,046	0
Reallocation of Deferred Revenue (Note 8)	0	0	0	0	2,906,708	2,906,708
Transfer Fund Balance (Note 1)	(5,482,417)	(5,482,417)	0	5,482,417	5,482,417	0
Fund Balance 06/30/99	($2,451,530)	$864,868	$3,316,398	$8,574,895	$10,640,458	$2,065,563

The accompanying notes are an integral part of this financial statement.

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Special Revenue Fund
Notes to the Financial Statements
For the Fiscal Year Ended June 30, 1999

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program
The State of Montana's Guaranteed Student Loan Program (MGSLP) is located in the Office of the Commissioner of Higher Education. As a Special Revenue Fund, it accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. MGSLP was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions within the State of Montana. Montana's Federal Family Education Loan Program operates in compliance with agreements with the U.S. Department of Education (DE), pursuant to Section 428 of the Higher Education Act of 1965, as amended (The Act).

B. Basis of Accounting
The financial statements were prepared using the modified accrual basis of accounting, and are presented in a budget to actual format, which does not significantly differ from a GAAP presentation. Under the modified accrual basis of accounting, expenditures are recorded on the basis of valid obligations. Revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. The budget information presented in the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual is as approved by the Montana Board of Regents for fiscal year 1999.

C. Separation of MGSLP Accounting Funds
The Higher Education Amendments of 1998 created a new Federal Student Loan Reserve Fund (FSLRF), which is the property of the U.S. Government. Guaranty agency reserves as of September 30, 1998, were to be deposited into the new FSLRF no later than 60 days after the enactment of the bill. Guaranty agencies were permitted to use their existing Federal Reserve Fund Account established pursuant to 34 CFR 682.410(a).

Use of the FSLRF is limited to payment of lender claims and payment of default aversion fees. Guarantors are required to deposit claim reimbursements from DE into the FSLRF, as well as the following: the Secretary's equitable share of defaulted loan recoveries, the portion of default recoveries that equals the complement of the reinsurance rate which is not reimbursed to guarantors by DE, student loan insurance premiums, Supplemental Preclaims Assistance payments received on or after 10/01/98, and 70% of Administrative Expense Allowance (AEA) received by the agency on or after 10/01/98.

During fiscal year 1999, MGSLP transferred net assets to the FSLRF totaling $5,482,417.

The Higher Education Amendments of 1998 also created an Agency Operating Fund (AOF), which is the property of the guarantors. The operating fund is to be used for a variety of FFELP activities and for other student aid related activities as selected by the guaranty agency. The payments guarantors receive from DE for loan processing and issuance, account maintenance, 30% of Administrative Expense Allowance (AEA) received by the agency on or after 10/01/98, and defaulted loan collections are to be deposited in the AOF. There is no required reserve level for the AOF.

2. DUE FROM FEDERAL GOVERNMENT

MGSLP pays individual lending institutions for any loans that have been defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The agency then seeks reimbursement from DE in accordance with reinsurance agreements between the agency and DE (See Note 16). Prior to October 1, 1998, claim payments and subsequent reinsurance payments were recorded in the Agency Operating Fund. Beginning October 1, 1998, claim payments and subsequent reinsurance payments were paid from and deposited into the Federal Student Loan Reserve Fund, as set forth in the Higher Education Amendments of 1998. MGSLP's claims for reinsurance payments not received as of June 30, 1999, are included here.

In addition, the receivable Due From Federal Government includes amounts MGSLP had not yet received for Loan Processing and Issuance Fees (LPIF) (Note 10) for the last quarter of fiscal year 1999. The extent of the outstanding reinsurance activity and other pending reimbursements from DE as of June 30, 1999, is shown below.

Reinsurance Claims	$3,082,116	Federal Reserve Fund
Loan Processing and Issuance Fee	$34,470	Agency Operating Fund
Total Due From Federal Government	$3,116,586	

3. SHORT TERM INVESTMENTS

Short Term Investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are reflected at cost, which equals market. At June 30, 1999, MGSLP owned 5,635,775 units valued at $1 per unit for a total of $5,635,775. During fiscal year 1999, MGSLP had investment earnings of $357,151. STIP securities include Banker's Acceptances, Commercial Paper, Corporate Obligations, Montana Certificates of Deposit, Government Securities, and Repurchase Agreements. At June 30, 1999, most securities, classified as Risk Category 1, were held by the state or its agent in the state's name. The remaining portions not classified were loaned under a security lending agreement with the state's agent.

The State of Montana's STIP investment portfolio contained asset-backed securities and variable rate securities with market values of $270,694,402 and $333,174,219; 21.6% and 26.6%, respectively, of the total portfolio at June 30, 1999, the most recent date figures are available. Board of Investment policy requires that STIP investments have the highest rating in the short-term category by at least one of the six Nationally Recognized Statistical Rating Organizations.

Asset-backed securities have less credit risk than securities not backed by pledged assets and market risk for these securities is the same as market risk for similar non asset-backed securities. While variable-rate securities have credit risk identical to similar fixed-rate securities, their market risk is more sensitive to interest rate changes. Market risk may be less volatile than fixed-rate securities because the value of variable-rate securities will usually remain at or near par. There are no legal risks that the Board of Investments is aware of regarding any STIP investments.

4. SECURITIES LENDING

Under the provisions of state statutes, the Board of Investments has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future.

During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal year 1999, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal year 1999 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal year 1999. Moreover, there were no losses during fiscal year 1999 resulting from a default of the borrowers or State Street.

During fiscal year 1999, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. On June 30, 1999, the Board had no credit risk exposure to borrowers.

5. FEDERALLY BACKED SECURITIES

MGSLP has established a separate account with the Montana Board of Investments for the investment of restricted funds as required by the Balanced Budget Act of 1997 (See Note 18). The amount transferred to the restricted account for fiscal year 1999 was $1,033,045 (annual transfer amount of $1,058,046 less the $25,001 overage deposited during fiscal year 1998). These funds are held in federally backed securities with a maximum maturity date of September 1, 2002. As of June 30, 1999, the account valuation was $2,046,280, as follows:

Principal	$2,023,000
Premium	$51,956
Amortization	($28,676)
Total	$2,046,280

6. PROPERTY HELD IN TRUST

MGSLP operates an escrow disbursement service for approximately forty lenders. Participating lenders are assessed a fee for this service. In accordance with contracts MGSLP has with the disbursement service lenders, MGSLP automatically debits the lenders' accounts to collect loan proceeds. MGSLP then disburses funds to the schools for delivery to the students either by individual State of Montana warrants or electronic transfers. The MGSLP disbursement service records all adjustments to individual student loan accounts and ensures that school refunds of loan proceeds are promptly returned to the lenders. Disbursement service revenues earned during fiscal year 1999 were

$103,850. As of June 30, 1999, MGSLP's disbursement service held $11,890 in student loan funds which were disbursed to the schools or refunded to the lenders after June 30,1999.

7. DUE TO FEDERAL GOVERNMENT

After assignment to the guaranty agency, MGSLP seeks collection of student loans that have been defaulted. Recoveries of loans reinsured by DE are owed back to DE (See Note 11). In addition, proceeds of loans sold back to lending institutions after a loan is rehabilitated or repurchased are also owed back to DE. At June 30, 1999, the amount owed to DE is $736,702. In addition, MGSLP owes $22,245 back to DE for repurchases.

8. GUARANTEE FEE INCOME

Guarantee fees are received from borrowers at the time loans are disbursed. In all years prior to fiscal year 1995 MGSLP charged a guarantee fee equivalent to 3% of the loan amount. Effective July 1, 1994, the maximum guarantee fee that borrowers may be charged decreased to 1% of the loan amount.

Prior to October 1, 1998, guarantee fees were deferred and recognized as revenue, using the straight-line method, over an eight-year period. This period approximated the average life of an outstanding student loan.

During fiscal year 1999 the Higher Education Amendments of 1998 required each guaranty agency to establish two funds – the Agency Operating Fund and the Federal Student Loan Reserve Fund (see Note 1C). The new legislation allows the FSLRF to be used only to pay lender claims and to pay default aversion fees into the AOF. The FSLRF may also be used to transfer up to the equivalent of 180 days of cash expenses for normal operating expenses (not including claim payments) to the AOF at any time during the first 3 years after establishment of the fund. In addition, Section 412(4) protects a guaranty agency from being forced to reduce reserves of the FSLRF below the amount of lender claim payments made during the 90-day period prior to reserve recall, so long as the guaranty agency charges a 1% guarantee fee.

During fiscal year 1999, MGSLP charged a guarantee fee of 1%. MGSLP determined that, under the new funding agreement with DE, guarantee fees are measurable and available upon receipt. From July 1 through September 30, 1998, guarantee fee revenues were deposited into the AOF. Beginning October 1, 1998, guarantee fee revenues were deposited into the FSLRF, and recognized as revenue upon receipt. As the single source of revenue for the FSLRF, guarantee fees are used to pay both current lender claims and default aversion fees. Guarantee fee revenue for the fiscal year ending 1999 was $828,729.

To accurately reflect the change in the relationship between guarantee fees and current period expenditures brought about by the Higher Education Amendments of 1998, the portion of the previously deferred revenue earned prior to fiscal year 1998 was closed to fund balance, and the fiscal year 1998 amount is recognized as prior year revenue. The amount transferred from the AOF to the FSLRF was $3,650,859, and was allocated as follows.

Prior Year Adjustment	$744,151
Closed to Fund Balance	$2,906,708
Total	$3,650,859

9. ADMINISTRATIVE EXPENSE ALLOWANCE

Prior to October 1, 1998, the Omnibus Budget Reconciliation Act of 1993 provided for payment of Administrative Expense Allowance (AEA) that was dependent upon federal appropriation on an annual basis. AEA reimbursements were calculated as 0.85% of the total consummated loan guarantees made during the quarter. The Higher Education Amendments of 1998 replaced the Administrative Expense Allowance with the Loan Processing and Issuance Fee (see Note 10) beginning October 1, 1998. Further, the Higher Education Amendments of 1998 directed that any AEA payments received after October 1, 1998 must be divided and deposited 30% to the Agency Operating Fund and 70% to the Federal Student Loan Reserve Fund. During fiscal year 1999 AEA payments totaled $516,797, of which $155,039 was deposited into the AOF and $361,758 was deposited into the FSLRF.

10. LOAN PROCESSING AND ISSUANCE FEE

The Higher Education Amendments of 1998 replaced the Administrative Expense Allowance with the Loan Processing and Issuance Fee (LPIF) beginning October 1, 1998. Under this Act, each guaranty agency is paid a loan processing and issuance fee, to be deposited into the Agency Operating Fund, equal to .65% of the total principal amount of loans originated during federal fiscal years 1999-2003 on which the agency issued insurance. Beginning with federal fiscal year 2004, the fee will drop to .40%. During fiscal year 1999, LPIF revenue totaled $168,744, which includes $34,470 accrued for reimbursements which were not received until after June 30, 1999.

11. COLLECTION COSTS RETAINED

MGSLP pursues collection, from the borrower or other responsible party, of defaulted loans held by the agency. The U.S. Secretary of Education is entitled to his equitable share of any recoveries, as determined by the rate of reinsurance on the defaulted loans less an allowance for collection cost reimbursement. Prior to October 1, 1998, the Omnibus Budget Reconciliation Act of 1993 established the agency's collection cost retention rate at 27%. Beginning October 1, 1998, the Higher Education Amendments of 1998 authorize guaranty agencies to deposit an amount equal to 24% of the payments made by or on behalf of a defaulted borrower into its Agency Operating Fund. Beginning October 1, 2003, the amount will be reduced to 23%. In addition, the Secretary provides the agency with collection costs amounting to 18.5% of the outstanding balance of any defaulted loan held by the agency which is consolidated by the borrower into a Federal Direct Consolidation Loan through either Federal Family Education Loan Program (FFELP) consolidation or Federal Direct Student Loan (FDSLP) consolidation. During fiscal year 1999 MGSLP retained $2,543,328 in collection costs from loan recoveries and direct loan consolidations.

12. SUPPLEMENTAL PRECLAIMS ASSISTANCE

Supplemental Preclaims Assistance (SPA) is a default prevention measure provided by MGSLP to borrowers that are between 120 and 270 days delinquent on their student loan payments. Delinquent borrowers are contacted to advise them of options available to bring their delinquent accounts current. Prior to October 1, 1998, DE reimbursed MGSLP for its SPA activities after a borrower successfully brought his or her account current. The reimbursement was computed as 1% of the outstanding delinquent account balance brought current. The Higher Education Amendments of 1998 replaced Supplemental

Preclaims Assistance with the Default Aversion Fee (see Note 13) beginning October 1, 1998. Reimbursements for SPA during fiscal year 1998 were $204,819.

13. DEFAULT AVERSION FEE

The Higher Education Amendments of 1998 provide for the payment of a Default Aversion Fee (DAF) beginning October 1, 1998, to replace Supplemental Preclaims Assistance (see Note 12). Upon receipt of a completed lender request for assistance (LRA) not earlier than the 60th day of delinquency, a guaranty agency must engage in default aversion activities designed to prevent a default by the borrower. For any loan on which a default claim is not paid by the guaranty agency on or before the 360th day of delinquency, the guaranty agency shall be paid a default aversion fee. The fee is equal to 1% of the total unpaid principal and accrued interest on the loan at the time the LRA is submitted. The default aversion fees are to be transferred from the Federal Student Loan Reserve Fund to the Agency Operating Fund no more frequently than monthly. The draft rule from DE's negotiated rulemaking process provides for payment of a fee equal to 1 % of the loan balance at the time an LRA is submitted, regardless of whether or not the loan is brought current. If the agency receives a default aversion fee and the account later defaults, the agency must rebate 1% of the claim amount to the FSLRF. The fee may be paid only once on any loan. During fiscal year 1999, Default Aversion Fee revenue and expense, for the Agency Operating Fund and FSLRF respectively, was estimated at $638,255, all of which was accrued at June 30, 1999. There was no transfer of default aversion fees during fiscal year 1999.

14. ACCOUNT MAINTENANCE FEE

The Higher Education Amendments of 1998 provide for the payment of an Account Maintenance Fee (AMF) beginning October 1, 1998. Under this Act, each guaranty agency is paid an account maintenance fee, to be deposited into the Agency Operating Fund, in an amount equal to .12% of the original principal balance of guaranteed loans outstanding during federal fiscal years 1999 and 2000. During federal fiscal years 2001 through 2003 the fee will drop to .10% of the original principal balance of guaranteed loans outstanding during the year. During fiscal year 1999 AMF revenue totaled $571,984.

15. ACCRUED INTEREST

During fiscal year 1999 MGSLP purchased claim eligible bankruptcy accounts from lending institutions. If the claim survived the bankruptcy discharge, MGSLP sold the bankruptcy claim back to a lending institution at its outstanding value, including interest which accrued during the bankruptcy proceedings. During fiscal year 1999, accrued interest earned on repurchased bankruptcy accounts was $24,534.

16. CONTINGENCIES

The outstanding principal balance of loans guaranteed by MGSLP as of June 30,1999, is approximately $624,765,977. This amount excludes bad debt, death, disability, and bankruptcy claims which have been previously purchased by the agency.
MGSLP has entered into agreements with DE, dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with The Act. These agreements allow for 100% reimbursement by DE for claims due to the death, disability, or bankruptcy of the borrower. Claims due to defaulted loans may be reimbursed by DE for up to 100%.

The percent of reimbursement on defaulted loans payable to the agency is dependent upon MGSLP's annual default rate and date of the original loan guarantee. Annual default rates are calculated as the ratio of year-to-date default purchases divided by the original guaranteed amount of loans in repayment status at the beginning of the federal fiscal year.

The following schedule reflects the federal reinsurance rates on defaulted student loans. In the event of extreme future adverse loss experience, MGSLP could be liable for up to 25% of the outstanding loan volume. Since its inception, MGSLP has paid $889,057 in claims, or portions of claim eligible loans, which were not reinsured by DE. During the fiscal year 1999 MGSLP recovered $142,293 of the total outstanding balance of non-reinsured claims held by the agency.

RATE OF ANNUAL DEFAULTS	**FEDERAL REINSURANCE On loans made prior to 10/01/93**	**FEDERAL REINSURANCE On loans made on or after 10/01/93 and prior to 10/01/98**	**FEDERAL REINSURANCE On loans made after 10/01/98**
0 – 5%	100%	98%	95%
Greater than 5% but less than or equal to 9%	90% of claims over 5 but less than or equal to 9%	88% of claims over 5 but less than or equal to 9%	85% of claims over 5 but less than or equal to 9%
Greater than 9%	80% of claims over 9%	78% of claims over 9%	75% of claims over 9%

17. COMMITMENTS

MGSLP is bound by Guarantee Reserve Agreements with the lending institutions participating in the Federal Family Education Loan Program in Montana. These agreements require MGSLP to maintain an amount in the guarantee reserve fund equal to at least 0.25% of the unpaid principal balance of all outstanding loans guaranteed by the agency. MGSLP's Guarantee Reserve Agreement with the Montana Higher Education Student Assistance Corporation (MHESAC), Montana's student loan secondary market, requires that its reserve fund be equal to at least 0.25% of the unpaid principal balance of all outstanding loans guaranteed by MGSLP.

The Guarantee Reserve Agreement ensures that MGSLP will have sufficient cash available to carry out its reasonably expected obligations on guaranteed claim eligible student loans. As of June 30, 1999, MGSLP was in compliance with all Guarantee Reserve Agreements.

18. RESERVED FUND BALANCES

The Balanced Budget Act of 1997, P.L. 105-33, signed August 5, 1997, provides for the U.S. Secretary of Education to recall $1 billion of guaranty agencies' reserve funds on September 1, 2002. Each agency's required share of the total recalled reserve funds has been calculated based on the total reserve fund dollars held by the agency as of September 30, 1996. For purposes of calculation, the reserves include any Federal reserve funds in cash or liquid assets held by the agency. The reserve ratio is defined as

the amount of the agency's federal reserve fund as of September 30, 1996, divided by the original principal amount of all outstanding insured loans on that date. In each of the federal fiscal years 1998 through 2002, each guaranty agency must transfer their required share, in equal annual installments, into a restricted account established by the agency, where funds will be held until final transfer to DE on September 1, 2002. Once deposited into the restricted account, an agency may not use the funds for any purpose without the express written permission of the Secretary. The Agency may use the investment earnings from the restricted account to perform certain default reduction activities, as outlined in the Balanced Budget Act of 1997. At the end of the five-year period, the reserve funds in the restricted account will be transferred to DE with a corresponding reduction in net assets. MGSLP's required share of the total recalled reserves is $5,290,229 or approximately 65% of MGSLP's available reserve balance at September 30, 1996. The amount held in trust as of June 30, 1999, was $2,116,092.

The Higher Education Amendments of 1998 require the Secretary to recall from guaranty agency federal student loan reserve funds an additional total of $85 million, $82.5 million, and $82.5 million in each of federal fiscal years 2002, 2006, and 2007 respectively. As of this date, DE has not determined the amounts to be recalled from individual guaranty agencies.

During fiscal year 1999 the Higher Education Amendments of 1998 required each guaranty agency to establish a Federal Student Loan Reserve Fund (see Note 1C). The new legislation specified that the FSLRF must be a separate account that contains only funds belonging to the FSLRF. A guaranty agency is allowed to use its existing Federal Reserve fund account established pursuant to CFR682.410(a) that satisfies the above requirement. MGSLP elected to use its existing reserve fund to account for the activities of the FSLRF. The amount of fund balance related to FSLRF activities, not restricted by the reserve recall, was $$8,524,366 as of June 30, 1999.

19. RECLASSIFICATION OF PROPERTY HELD IN TRUST

During fiscal year 1999 the Higher Education Amendments of 1998 required each guaranty agency to establish a Federal Student Loan Reserve Fund (see Note 1C). The new legislation specified that the FSLRF must be a separate account that contains only funds belonging to the FSLRF. A guaranty agency is allowed to use its existing Federal Reserve fund account established pursuant to CFR682.410(a) that satisfies the above requirement. MGSLP elected to use its existing reserve fund to account for the activities of the FSLRF. The statute further stipulates that the FSLRF are the property of the United States.

As a result of the establishment of the FSLRF and this change in accounting for federal monies, the amount shown in the previous fiscal year as Property Held in Trust for reserve recall (see Note 18) has been reclassified as part of the fund balance in the FSLRF, and is reported in that fund as part of the reserved fund balance.

20. CLAIMS PAID TO LENDERS AND REINSURANCE FROM DEPARTMENT OF EDUCATION

MGSLP records amounts paid to lenders for claims and subsequent amounts received from DE as expenses and revenues respectively. The difference between these two amounts is reflected as Claims Paid to Lenders (non-reinsured). For fiscal year 1999, MGSLP paid claims totaling $19,027,868 and received reinsurance from DE totaling $18,828,699; the difference between the two accounts is $199,169.

21. FIXED ASSETS

MGSLP is accounted for on the Statewide Budgeting and Accounting System (SBAS) as a special revenue fund. The fixed assets of MGSLP, which total $118,181 as of June 30, 1999, are valued at cost. MGSLP fixed assets are included in the General Fixed Assets Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

22. COMPENSATED ABSENCES LIABILITY

MGSLP's liability for compensated absences, which totals $132,599 as of June 30,1999, is included in the Long Term Debt Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

23. LEASES

MGSLP has entered into an operating lease for office facilities and a capital lease for a photocopier. The operating lease, which expires in November 2008, had total rental payments during fiscal year 1999 of $143,649. The balance of the capital lease at June 30, 1999, was $5,251. Total payments to principal during fiscal year 1998 were $3,114. Future minimum lease payments under the lease agreements as of the end of the previous fiscal year are as follows:

FY Ending June 30	Operating Lease	Capital Lease	
		Principal	Interest
2000	$140,633	$3,410	$338
2001	$140,643	$1,841	$49
2002	$141,100	--	--
2003	$140,920	--	--
2004	$141,034	--	--
2005+	$618,572	--	--

24. RELATED PARTY TRANSACTIONS

The Montana Board of Regents, which governs MGSLP, is the guarantor of the loans owned by MHESAC. The Board of Regents and MHESAC have four common board members. Approximately 45.66% of MGSLP's outstanding loan volume is held by MHESAC.

MGSLP has an agreement with MHESAC to share certain costs for the lease of computer equipment; computer and software maintenance costs; computer supply, photocopy, and facsimile expenses; and personnel costs for employees of MHESAC who perform services that are of direct benefit to MGSLP. Certain MHESAC personnel are authorized to purchase computer equipment for use by both MGSLP and MHESAC. Costs for these purchases are covered under the shared cost agreement between the two entities. MGSLP also receives certain services from the State of Montana for telephone, postage, and computer supplies that directly benefit MHESAC. MHESAC reimburses MGSLP for these services.

During fiscal year 1998, MGSLP's portion of shared costs reimbursed to MHESAC was $497,059. MGSLP was reimbursed for $203,941 of shared costs by MHESAC.

25. EMPLOYEES' RETIREMENT SYSTEM

MGSLP employees are covered by the Public Employees' Retirement System (PERS) or the Teachers Retirement System (TRS). Professional employees with contracts under the authority of the Board of Regents are covered by the Optional Retirement Program (ORP), which is available through the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) unless they were previously members of the TRS, in which case they may choose to enter the TRS. The classified staff is provided a retirement program through the Montana Public Employees' Retirement System (PERS).

Defined Benefit Plans

Public Employees' Retirement System (PERS)
Established in 1945 and governed by Title 19, chapter 3, MCA, PERS participants are eligible to retire at age 60 with at least five years of service; at age 65 regardless of length of service; or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989, monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals five years. Under PERS, the state contributed 6.800% of an employee's gross wages. The employee contributed 6.800% of his/her gross wages.

Teachers' Retirement System (TRS)
The TRS was established in 1937 and is governed by Title 19, chapter 20, MCA. Teachers Retirement System participants are eligible to retire with a minimum 25 years of membership service or five years of creditable service at age 60. A retirement benefit is 1/60 times the years of service times average final compensation. An employee is vested in TRS following completion of five years of creditable service. Vested employees may retire at or after age 50 and receive a reduced retirement benefit. Under TRS, the state contributed 7.470% of an employee's gross wages. The employee contributed 7.044% of his/her gross wages.

Defined Contribution Plan

Optional Retirement Program (ORP)
ORP was established in 1988 and is underwritten by the Teachers' Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF). The ORP is a defined contribution plan. Contribution rates for the plan are required and determined by State law. The state's contributions were equal to the required contribution. The benefits at retirement depend upon the amount of contributions, amounts of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. The state records employee/employer contributions and remits monies to TIAA-CREF. Individuals are immediately vested with contributions. Under ORP, the state contributed 4.956% of an employee's gross wages. The employee contributed 7.044% of his/her gross wages. In addition, a total of $1,398 or 3.12% was contributed to TRS from ORP employer contribution to amortize past service unfunded liability in accordance with state law.

The State's policy is to fund accrued pension costs although unfunded liabilities exist. Based on their most recent actuarial valuation reports, the PERS and TRS were actuarially sound.

Trend information, indicating the progress made toward accumulating assets needed to pay retirement benefits when they are due, is not available on an agency basis. This information is available on a statewide basis in the Retirement Systems' annual reports.

Retirement Plan Information for MGSLP as of June 30, 1999

	PERS	TRS	ORP
Covered Payroll	$906,515	$71,473	$44,792
Total Payroll	$1,019,256	$1,019,256	$1,019,256
Employer Contributions	$61,643	$5,339	$2,222
Percent of Covered Payroll	6.80%	7.47%	4.956%
Employee Contribution	$61,643	$5,035	$3,153
Percent of Covered Payroll	6.80%	7.044%	7.044%

26. YEAR 2000

The Year 2000 issue is the result of shortcomings in many electronic data processing systems and other electronic equipment that may adversely affect the operations of many entities beginning in 1999. The problem is that many computer programs use only the last two digits when referring to a year. Many programs will not be able to distinguish between the year 2000 and the year 1900 or may not be able to recognize that 2000 is a leap year. This may cause inaccurate processing of information or a complete halt to processing.

MGSLP has been addressing the Year 2000 issue for the last two years. The major administrative support systems have been or are currently being replaced or upgraded to systems that are Year 2000 compliant. These systems include SABHRS (purchasing, payables, receivables, and accounting), EAGLE (education loan management), and DARS (default collections).

MGSLP does not anticipate disruption of services as a result of non-compliant internal systems. However, because of the unprecedented nature of the Year 2000 issue and the interaction with and dependence on third parties, the effects of and the success of remedial efforts will not be fully determinable until fiscal year 2000 or thereafter.

MONTANA GUARANTEED STUDENT LOAN PROGRAM

Mailing Address:
P.O. Box 203101
Helena, MT 59620-3101

(406) 444-6594
Fax (406) 444-1869
www.mgslp.state.mt.us

Delivery Address:
2500 Broadway
Helena, MT 59601-4989

Customer Assistance (800) 537-7508

OCT 21 1999

October 18, 1999

Scott A. Seacat
Legislative Auditor
Capitol Station
Helena, MT 59620

Dear Scott:

This letter confirms completion of the Montana Guaranteed Student Loan Program audit for fiscal year 1999, performed by your staff. It is my understanding that there were no findings or recommendations.

I want to take this opportunity to thank you and your staff for the thorough and professional manner in which the audit was performed. Please be assured that the staff at MGSLP will continue in our goal to provide excellent service to students, lenders, and educational institutions. The confidence of lenders and schools is of the utmost importance in our ability to provide students with access to higher education.

Sincerely,

Arlene J. Hannawalt

Arlene J. Hannawalt
Director